Annex

Proposed Amendments to Banking (Capital) Rules[1]

Implementation of Capital Requirements for Banks' Equity Investments in Funds under the STC Approach and the BSC Approach

I. New provisions for translating BCBS standards into local regulations

1. New definitions

CIS exposure means the collective investment scheme exposure;

collective investment scheme exposure means an on-balance sheet or off-balance sheet exposure to a collective investment scheme in the form of, or having the same credit risk as, an equity investment in the scheme, including such an exposure arising from—

(a) the holding of units or shares in the scheme; and

(b) a commitment to subscribe to the scheme's future capital calls;

fall-back approach means the approach for determining the risk-weighted amount of a CIS exposure or an underlying exposure[2] of a collective investment scheme set out in section <u>X10</u>;

look-through approach means the approach for determining the risk-weighted amount of an underlying exposure of a collective investment scheme set out in section <u>X7</u>;

mandate-based approach means the approach for determining the risk-weighted amount of an underlying exposure of a collective investment scheme set out in section <u>X8</u>;

future holding, in relation to an authorized institution, means the institution's potential future holding of a regulatory deductible item falling within section 44(2)(c), 47(2)(c), 48(2)(b) or 48A(2);

regulatory deductible item, in relation to the calculation of the risk-weighted amount of a CIS exposure by an authorized institution, means—

(a) a CET1 capital instrument, an Additional Tier 1 capital instrument or a Tier 2 capital instrument issued by a financial sector entity (including the institution);

(b) a non-capital LAC liability of a financial sector entity (including the institution); or

(c) a capital instrument issued by a financial sector entity that is treated as—

(i) a CET1 capital instrument under section 4(1)(c) of Schedule 4F or section 1(4)(d) of Schedule 4G; or

(ii) an Additional Tier 1 capital instrument or a Tier 2 capital instrument under section 4(3) of Schedule 4F or section 1(6) of Schedule 4G;

[1] Unless otherwise specified, any existing provisions or section numbers cited in this document refer to those of the Banking (Capital) Rules as revised by the Banking (Capital) (Amendment) Rules 2018.

[2] See the proposed revised definition of "underlying exposures" set out in paragraph 3 below.

third-party approach means the approach under which an authorized institution relies on a third party to—

(a) look through to an underlying exposure of a collective investment scheme; and

(b) determine the risk-weight or risk-weighted amount of the underlying exposure in a manner as if the third party were a bank that holds the underlying exposure directly.

2. New Division 4A to be added after Division 4 of Parts 4 and 5

Division 4A—Calculation of Risk-weighted Amount of Authorized Institution's CIS Exposures

X5. Application of Division 4A

This Division applies to CIS exposures that are held by an authorized institution in its banking book.

X6. Approaches to be used for determining risk-weighted amount of underlying exposure of collective investment scheme

[Version for STC approach:

(1) Subject to subsection (5) and section X11, an authorized institution must determine the risk-weighted amount of the underlying exposures of a collective investment scheme to which the institution has a CIS exposure—

(a) if both of the conditions set out in subsection (2) are met in respect of the scheme—by using the look-through approach; or

(b) if either or both of the conditions set out in subsection (2) are not met in respect of the scheme—in accordance with subsection (1A).

(1A) The institution may use the third-party approach to determine the risk-weighted amount of the underlying exposures if it has verified by appropriate means that all the conditions in section X7A(1) are met in respect of the calculations performed by the third party concerned, otherwise, the institution must determine the risk-weighted amount of the underlying exposures by using—

(a) the mandate-based approach; or

(b) where it is not feasible to use the mandate-based approach—the fall-back approach.]

[Version for BSC approach:

`

(1) Subject to section X11, an authorized institution may, at its own discretion, choose to determine the risk-weighted amount of the underlying exposures of a collective investment scheme to which the institution has a CIS exposure by using either—

(a) the fall-back approach; or

(b) the approach determined in accordance with subsection (1A).

(1A) Subject to subsection (5), an authorized institution must determine the risk-weighted amount of the underlying exposures of a collective investment scheme to which the institution has a CIS exposure—

(a) if both of the conditions set out in subsection (2) are met in respect of the scheme—by using the look-through approach;

(b) if either or both of the conditions set out in subsection (2) are not met in respect of the scheme—in accordance with subsection (1B).

(1B) The institution may use the third-party approach to determine the risk-weighted amount of the underlying exposures if it has verified by appropriate means that all the conditions in section X7A(1) are met in respect of the calculations performed by the third party concerned, otherwise, the institution must determine the risk-weighted amount of the underlying exposures by using—

(a) the mandate-based approach; or

(b) where it is not feasible to use the mandate-based approach—the fall-back approach.

Explanatory note: Under the BSC approach, it is proposed to allow an AI to use the fall-back approach to risk-weight all its CIS exposures even though using another approach (e.g. look-through approach) is feasible. This should help reduce the burden of small AIs that have minimal CIS exposures.]

(2) The conditions are as follows—

(a) there is sufficient and frequent information available to the institution regarding the underlying exposures of the scheme; and

(b) the information and underlying exposures are verified by an independent third party who may be a depository, a custodian bank or (where applicable) a management company.

(3) The condition in subsection (2)(a) is met in respect of the scheme only if—

(a) the frequency of financial reporting of the scheme is the same as, or more frequent than, that of the institution's financial reporting; and

(b) the granularity of the financial information provided in the scheme's financial report is sufficient for determining the risk-weighted amount of its underlying exposures in accordance with the look-through approach.

(4) For the purposes of subsection (3), the financial report of a collective investment scheme needs not be an audited report.

(5) An authorized institution may use any combination of the look-through approach, third-party approach, mandate-based approach and fall-back approach to determine the risk-weighted amount of the underlying exposures of a collective investment scheme to which it has a CIS exposure if—

(a) it is not feasible to use the same approach for all the underlying exposures; and

(b) the requirements applicable to the approach concerned set out in this Division are met in respect of the underlying exposures for which the approach is used.

X7A. Conditions for using third-party approach[3]

(1) The conditions specified for using the third-party approach are—

(a) the third party determines the risk-weighted amount of the underlying exposure concerned (***third-party output)*** in accordance with section X7(1) as if it were an authorized institution that holds the underlying exposure directly; and

(b) subject to subsection (2), the third-party output is at least 1.2 times higher than the risk-weighted amount that would be determined for the underlying exposure under section X7(1) if the underlying exposure were held directly by an authorized institution that calculates its credit risk by using the STC approach.

[*Explanatory note:*

- *Under the proposed sections X6(1A) (or X6(1B) in the case of the BSC approach) and X7A(1), if no third party is able or willing to provide data calculated in accordance with section X7(1) of the Banking (Capital) Rules, the AI must use the mandate-based approach or the fall-back approach, as the case requires, to determine the risk-weighted amount of the underlying exposure. In other words, the third-party approach must not be used.*
- *In the proposed section X7A(1)(b), instead of a strict requirement that the risk-weight must be exactly 1.2 times higher than the one that would be applicable if the exposure were held directly by the AI, more flexible wording of "at least 1.2 times" is proposed so that there is some leeway to deal with, for example, cases where the AI's own calculations for the purpose of verification result in a figure of 1.22 that is larger than 1.2 due to rounding.*]

[***Consultation question 1:*** *Do you have any comments on the proposed ways in which the corresponding BCBS requirements on third-party calculations are reflected in the local rules?*]

(2) If an authorized institution does not have sufficient information to verify whether the third-party output meets the condition in subsection (1)(b), the institution may regard the condition as being met provided that the institution will multiply the third-party output by a factor of 1.2 and no amount other than the product so calculated will be taken as the risk-weighted amount of the underlying exposure for the purposes of section X12.

X7. Look-through approach

(1A) This section sets out the look-through approach for determining the risk-weighted amount of the underlying exposure of a collective investment scheme.

[3] The same wording is used under both the STC approach and the BSC approach, i.e. third parties are not expected to calculate the risk-weighted amount by using the BSC approach.

[Version for STC approach:

(1) Subject to sections X8A and X9, an authorized institution must determine the risk-weighted amount of the underlying exposure in accordance with Part 4 or 7, or Division 4 of Part 6A, as the case requires, as if the underlying exposure were held directly by the institution.]

[Version for BSC approach:

(1) Subject to sections X8A and X9, an authorized institution must determine the risk-weighted amount of the underlying exposure in accordance with Part 5 or 7, or Division 4 of Part 6A, as the case requires, as if the underlying exposure were held directly by the institution.]

X8. Mandate-based approach

(1A) This section sets out the mandate-based approach for determining the risk-weighted amount of the underlying exposures of a collective investment scheme.

(1) An authorized institution must determine the risk-weighted amount of the underlying exposures of the collective investment scheme based on the information contained in any one or more of the following documents—

(a) the mandate of the collective investment scheme;

(b) if applicable, the legislation or regulations governing such scheme; and

(c) other disclosures made by such scheme.

(2) Subject to sections X8A and X9, in determining the risk-weighted amount of the underlying exposures of the collective investment scheme, the institution must—

[Version for STC approach:

(a) risk-weight the underlying exposures of the scheme in accordance with Part 4 or 7, or Division 4 of Part 6A, as the case requires, as if the underlying exposures were held directly by the institution;]

[Version for BSC approach:

(a) risk-weight the underlying exposures of the scheme in accordance with Part 5 or 7, or Division 4 of Part 6A, as the case requires, as if the underlying exposures were held directly by the institution;]

(b) assume that the scheme first incurs exposures that would attract the highest capital requirements under paragraph (a), and then continues to incur exposures in descending order of capital requirements, to the maximum extent allowed under the scheme's mandate or the relevant legislation or regulations;

(c) for underlying exposures of the scheme falling within paragraph (ab)(ii) of the definition of ***underlying exposures*** in section 2(1) that arise from derivative contracts entered into by the scheme (***concerned underlying exposures***), take

the following amount as the amount of the concerned underlying exposures subject to risk-weighting—

(i) the notional amount of the scheme's position in the underlying exposures of the derivative contracts;

(ii) if the underlying exposures of the derivative contracts are unknown—the full notional amount of the contracts; or

(iii) if the notional amount of the derivative contracts is unknown—the amount estimated by the institution by using the maximum notional amount of derivative contracts allowed under the scheme's mandate or the relevant legislation or regulations;

[Version for STC approach:

(d) for underlying exposures of the scheme falling within paragraph (ab)(iii) of the definition of ***underlying exposures*** in section 2(1) that arise from derivative contracts entered into by the scheme, calculate the default risk exposure in respect of the derivative contracts by using the SA-CCR approach[4]; and]

[Version for BSC approach:

(d) for underlying exposures of the scheme falling within paragraph (ab)(iii) of the definition of ***underlying exposures*** in section 2(1) that arise from derivative contracts entered into by the scheme, calculate the default risk exposure in respect of the derivative contracts by using—

(i) the SA-CCR approach; or

(ii) the current exposure method, where—

(A) if the replacement cost of a derivative contract is unknown—the notional amount of the contract is to be taken as the replacement cost; and

(B) if the CCF applicable to a derivative contract is unknown—a CCF of 47%[5] is to be applied; and]

(e) for any other underlying exposures of the scheme, take the following amount as the amount of the underlying exposures subject to risk-weighting—

(i) the contracted amount of the transactions concerned; or

(ii) if the contracted amount is unknown—the amount estimated by the institution by using the maximum contracted amount allowed under the scheme's mandate or the relevant legislation or regulations.

(3) If the information available to the institution is not sufficient such that more than one risk-weight are applicable to an underlying exposure of a collective investment

[4] Subject to further guidance from the Basel Committee on the treatments when there is insufficient information on the derivative contracts for using the SA-CCR approach.

[5] This is the highest CCF proposed for the modified current exposure method (see the consultation paper issued in 10 August 2018).

scheme, the institution must assign to the underlying exposure the highest of those applicable risk-weights.

X8A. Treatments for collective investment scheme that has CIS exposure to another collective investment scheme

(1) Subsections (2) and (3) apply to a collective investment scheme (***CIS A***) to which an authorized institution has a CIS exposure if—

(a) the institution uses either the look-through approach or the mandate-based approach to determine the risk-weighted amount of—

(i) all of the underlying exposures of CIS A; or

(ii) part of the underlying exposures of CIS A; and

(b) the underlying exposures referred to in paragraph (a)(i) or (ii) (***first layer underlying exposures***) consist of one or more CIS exposures to one or more collective investment schemes (each such scheme, ***CIS B***).

[*Explanatory note:*

- *If the AI uses the third-party approach or the fall-back approach for the purpose of calculating the risk-weighted amount of its CIS exposure to CIS A, the AI does not need to calculate the risk-weighted amount of the underlying exposures held by CIS A by itself. Hence, this section is irrelevant to the AI as far as its CIS exposure to CIS A is concerned.*
- *Section X8A(1)(a)(ii) is to cater for cases where a combination of approaches is used (e.g. look-through approach ("**LTA**") for on-balance sheet assets and mandate-based approach ("**MBA**") for off-balance sheet exposures) to calculate the risk-weighted amount of the underlying exposures of CIS A.*]

(2) When determining the risk-weighted amount of the first layer underlying exposures in accordance with section X7 or X8, the institution must determine the approach to be used to determine the risk-weighted amount of the underlying exposures of CIS B (***second layer underlying exposures***) in accordance with section X6 as if CIS A's CIS exposure to CIS B were the institution's own CIS exposure.

[*Explanatory note: Suppose an STC AI uses LTA to calculate the risk-weighted amount ("**RWA**") of all the underlying exposures of CIS A and one of the underlying exposures is a CIS exposure to CIS B ("**CIS expo B**")—*

- *according to section X7, the AI must calculate the RWA of the underlying exposure, i.e. **CIS expo B**, ("$\boldsymbol{RWA_{CIS\ expo\ B}}$") in accordance with Part 4 as if it were the AI's own CIS exposure. In other words, the AI must calculate $\boldsymbol{RWA_{CIS\ expo\ B}}$ in accordance with Division 4A of Part 4; and*
- *in calculating $\boldsymbol{RWA_{CIS\ expo\ B}}$, the AI needs to determine the appropriate approach for calculating the RWA of the underlying exposures held by CIS B ("$\boldsymbol{RWA_{CIS\ B's\ underlying}}$") in accordance with section X6.*]

(3) Subsection (4) applies to the institution if—

(a) under subsection (2), the institution uses either the look-through approach or the mandate-based approach to determine the risk-weighted amount of all or part of the second layer underlying exposures; and

(b) those second layer underlying exposures that are subject to the look-through approach or the mandate-based approach consist of at least one CIS exposure.

[*Explanatory note: The logic of section X8A(1) also applies to section X8A(3).*]

(4) For any CIS exposures (including a CIS exposure directly held by CIS B) to any subsequent layers of collective investment schemes (each such layer, ***CIS X***) held indirectly by CIS A through CIS B—

(a) the risk-weighted amount of the underlying exposures of CIS X may be determined by using the look-through approach only if—

(i) the risk-weighted amount of all or part of the underlying exposures of a collective investment scheme in the layer immediately above CIS X is also determined by using the look-through approach;

(ii) the CIS exposure to CIS X is one of those underlying exposures that are subject to the look-through approach; and

(iii) both of the conditions set out in section X6(2) are met in respect of CIS X; or

(b) in any other case, the risk-weighted amount of the CIS exposure to CIS X must be determined by using the fall-back approach.

[*Explanatory note: Suppose under section X8A(2), the AI determines that according to section X6 it is feasible to use LTA to calculate* ***RWA****$_{\textit{CIS B's underlying}}$ and one of the underlying exposures held by CIS B is a CIS exposure to CIS C ("****CIS expo C****")—*

- *unlike section X8A(2) where the approach for calculating* ***RWA****$_{\textit{CIS B's underlying}}$ is determined in accordance with section X6, the approach for calculating the RWA of the underlying exposures of CIS C ("****RWA****$_{\textit{CIS C's underlying}}$") is determined in accordance with section X8A(4). The same applies to subsequent layers such as CIS D's holding of CIS exposures to CIS E and CIS E's holding of CIS exposures to CIS F;*
- *under section X8A(4), the AI may use LTA to calculate* ***RWA****$_{\textit{CIS C's underlying}}$ for the purpose of calculating the RWA of* ***CIS expo C*** *only if the conditions for using LTA set out in section X6 are met, otherwise, the fall-back approach must be used to calculate the RWA of* ***CIS expo C****.*]

X9. Supplementary requirements for look-through approach and mandate-based approach

(1) This section applies to underlying exposures of a collective investment scheme (***CIS Y***) of which the risk-weighted amounts are determined by an authorized institution by—

(a) using the look-through approach; or

(b) using the mandate-based approach.

(2) If an underlying exposure of CIS Y is a direct holding of a regulatory deductible item (***subject holding***) or an exposure that would be an indirect holding, a synthetic holding or a future holding of a regulatory deductible item if the exposure were held directly by the institution (***subject exposure***), the institution must—

(a) disregard—

(i) Division 4 of Part 3 (including the associated Schedules); and

[Version for STC approach:

(ii) section 66(1)(a) and (2), to the extent related to holdings of regulatory deductible items, and section X11; and]

[Version for BSC approach:

(ii) section 116(1)(a) and (2), to the extent related to holdings of regulatory deductible items, and section X11; and]

(b) determine the risk-weighted amount of the whole amount of CIS Y's subject holding or subject exposure, as the case may be, in accordance with the other applicable provisions of this Part as if the instrument or liability concerned were not a regulatory deductible item.

[*Explanatory note:*

- *Under LTA and MBA, the AI must risk-weight the underlying exposures held by CIS Y as if they were its own exposures. In such case, if CIS Y has any investments in, say ordinary shares of banks or index funds that hold ordinary shares of banks, the AI will be required to risk-weight CIS Y's investments in the shares or funds as if the investments were held by the AI directly. Accordingly, the risk-weighting treatments in section 66 (or 116 in the case of the BSC approach) for significant / insignificant LAC investments would be applicable to CIS Y's investments in the shares and section X11 would be applicable to CIS Y's investments in the funds if section X9(2) did not exist.*
- *In section X9(2)(a)(ii), section 66(1)(a) and (2) is relevant to holdings that are not in the form of CIS exposures (e.g. investments in ordinary shares of banks or derivative contracts on the ordinary shares of banks) while section X11 is relevant to holdings in the form of CIS exposures (e.g. investments in index funds whose holdings include ordinary shares of banks). Similarly for the BSC approach.*]

(3) If an underlying exposure of CIS Y is a capital investment in a commercial entity, the institution must—

[Version for STC approach:

(a) disregard sections 43(1)(n), 46(1) and 68A; and]

[Version for BSC approach:

(a) disregard sections 43(1)(n), 46(1) and 117A; and]

(b) determine the risk-weighted amount of the whole amount of CIS Y's capital investment in the commercial entity in accordance with the other applicable provisions of this Part.

(4) To avoid doubt—

(a) CIS Y may be—

(i) a collective investment scheme to which the institution has a CIS exposure; or

(ii) a collective investment scheme to which the scheme falling within subparagraph (i) has a CIS exposure directly or indirectly;

(b) an authorized institution's indirect holding or synthetic holding of any regulatory deductible item resulted from the institution's CIS exposure to a collective investment scheme is still subject to the requirements under Division 4 of Part 3 (including the associated Schedules) and, if applicable, section X11, even though the whole amount of the subject holding or subject exposure concerned has already been risk-weighted under subsection (2).

[*Explanatory note: See section X12(2) below for the proposed treatment to avoid double counting any part of the CIS exposure that has been deducted under Division 4 of Part 3 or risk-weighted under section X11.*]

(5) If an underlying exposure of CIS Y is an exposure to CVA risk in respect of derivative contracts or SFTs entered into by CIS Y with a counterparty, the institution must use the following method, instead of the methods set out in Division 3 of Part 6A, to determine the risk-weighted amount of the underlying exposure—

(a) subject to subsection (6), multiply the total of the amounts specified in subparagraph (i) or (ii), as the case requires, by a factor of 0.5—

(i) in the case of derivative contracts and SFTs for which default risk exposures are not determined under section X53[6]—the default risk exposures calculated for the contracts and SFTs;

(ii) in the case of SFTs for which default risk exposures are determined under section X53—the default risk exposures, after taking into account the credit risk mitigating effect of the money or securities received by CIS Y under the SFTs, calculated for the SFTs; and

(b) apply to the resultant amount the risk-weight applicable to the counterparty so as to arrive at the risk-weighted amount of the underlying exposure.

(6) The institution may exclude from the calculations under subsection (5) the following transactions and contracts—

(a) SFTs where no information obtained by the institution for the purposes of using the look-through approach or the mandate-based approach suggests that the scheme's CVA risk arising from SFTs is material; and

(b) transactions and contracts that would not be subject to the CVA capital charge under section 226N if CIS Y were an authorized institution.

[6] Please see the consultation paper on SA-CCR and other related proposed amendments issued on 10 August 2018.

[***Consultation question 2:*** *Do you have any comments on the above proposed risk-weighting treatments of funds' holdings of capital instruments / non-capital LAC liabilities?*]

X10. Fall-back approach

(1A) This section sets out the fall-back approach for determining the risk-weighted amount of a CIS exposure or an underlying exposure of a collective investment scheme.

(1) An authorized institution must apply a 1250% risk-weight to the CIS exposure or to the underlying exposure, as the case requires.

[*Explanatory note: If an AI has a CIS exposure to a collective investment scheme and it uses the fall-back approach together with another approach to calculate the risk-weighted amount of the underlying exposures of the scheme, the 1250% risk-weight has to be applied to the underlying exposures concerned rather than to the CIS exposure directly.*]

(2) To avoid doubt—

(a) a reference to an underlying exposure in subsection (1) includes—

(i) the whole amount of any of the scheme's direct holding of a regulatory deductible item (***subject holding***);

(ii) the whole amount of any of the scheme's exposure that would be an indirect holding, a synthetic holding or a future holding of a regulatory deductible item if the exposure were held directly by the institution (***subject exposure***); and

(iii) the whole amount of any of the scheme's capital investment in a commercial entity; and

(b) an authorized institution's indirect holding or synthetic holding of any regulatory deductible item resulted from the institution's CIS exposure to a collective investment scheme is still subject to the requirements under Division 4 of Part 3 (including the associated Schedules) and, if applicable, section X11, even though the whole amount of the subject holding or subject exposure concerned has already been risk-weighted under subsection (1).

[*Explanatory note: See section X12(2) below for the proposed treatment to avoid double counting any part of the CIS exposure that has been deducted under Division 4 of Part 3 or risk-weighted under section X11.*]

X11. Authorized institutions' CIS exposures constituting holdings of regulatory deductible items

(1) This section applies to an authorized institution's CIS exposure or any part of it that constitutes—

(a) the institution's direct holding, indirect holding, synthetic holding or future holding of an item falling within paragraph (a) or (c) of the definition of ***regulatory deductible item***; or

(b) the institution's indirect holding, synthetic holding or future holding of an item falling within paragraph (b) of the definition of ***regulatory deductible item***.

[Explanatory note: It is proposed that section 66 (in the case of STC approach) and section 116 (in the case of BSC approach) only apply to non-CIS exposures (see the proposed amendments set out in paragraphs 6 and 8 below). Section X11 reinstates the risk-weighting treatments for holdings of capital instruments issued by, and non-capital LAC liabilities of, financial sector entities in sections 66(1)(a) and (2) and 116(1)(a) and (2). Accordingly, any amounts of holdings of capital instruments / non-capital LAC liabilities in the form of CIS exposures that are not subject to capital deduction have to be risk-weighted in accordance with section X11]

(2) In either of the following circumstances—

(a) where—

(i) any of the holding in subsection (1)(a) and (b) is an insignificant LAC investment; and

(ii) all or part of such holding is not subject to deduction from the institution's capital base under sections 43(1)(o), 47(1)(c) and 48(1)(c); or

(b) where—

(i) any of the holding in subsection (1)(b) falls within section 48A; and

(ii) all or part of such holding is not subject to deduction from the institution's capital base under section 48(1)(g)(i),

any amount of the holding falling within paragraph (a)(ii) or (b)(ii) must be assigned a risk-weight of 100%.

[*Explanatory note: Equivalent to section 66(1)(a)(i) and (iii) and (2)(a) and section 116(1)(a)(i) and (iii) and (2)(a).*]

(3) If—

(a) any of the holding in subsection (1)(a) is a significant LAC investment; and

(b) all or part of such holding is not subject to deduction from the institution's CET1 capital under section 43(1)(p),

any amount of the holding falling within paragraph (b) must be assigned a risk-weight of 250%.

[*Explanatory note: Equivalent to section 66(1)(a)(ii) and (2)(b) and section 116(1)(a)(ii) and (2)(b).*]

(4) To avoid doubt, the indirect holding and synthetic holding referred to in subsection (1)(a) and (b) also include those resulted from an exposure—

(a) that is held by a collective investment scheme as described in section X9(4)(a)(ii); and

(b) that would be an indirect holding or a synthetic holding of a regulatory deductible item if the exposure were held directly by an authorized institution.

X12. Calculation of risk-weighted amount of CIS exposure

(1) The risk-weighted amount of a CIS exposure (***RWA**$_{CIS\ exposure}$*) is calculated by using Formula 1A—

Formula 1A

$$RWA_{CIS\ exposure} = \text{Effective RW} * P_{CIS\ exposure}$$

where—

(a) Effective RW is—

(i) if all the underlying exposures of the collective investment scheme concerned are risk-weighted by using the fall-back approach—1250%; or

(ii) in any other case—the effective risk-weight applicable to the CIS exposure calculated by multiplying Avg RW_{CIS} by Leverage, subject to a cap of 1250%;

(b) Avg RW_{CIS} is the amount calculated by dividing the amount specified in subparagraph (i) by the amount specified in subparagraph (ii)—

(i) the aggregate risk-weighted amount of the underlying exposures determined in accordance with the other sections in this Division;

(ii) the total assets of the scheme;

(c) Leverage is—

(i) if the risk-weighted amount of all or part of the underlying exposures of the scheme is determined by using the look-through approach or the third-party approach—the ratio of the total assets of the scheme to its total equity; or

(ii) if subparagraph (i) is not applicable and the risk-weighted amount of all or part of the underlying exposures of the scheme is determined by using the mandate-based approach—the maximum financial leverage permitted by the scheme's mandate or by the legislation or regulations governing the scheme, as the case may be;

[*Explanatory note: The BCBS standard is silent on the manner in which the leverage should be calculated / determined in cases where a combination of approaches is used in calculating the risk-weighted amount of the underlying exposures of a collective investment scheme. The treatment proposed in section X12(1)(c) is based on the assumption that if the look-through approach can be used on some of the underlying exposures, it is highly likely that the AI can calculate the leverage in accordance with section X12(1)(c)(i). Similarly, if the mandate-based approach can be used on some of the underlying exposures, information on the mandate/legislation/regulation concerned should be available to the AI.*]

[***Consultation question 3:*** *Do you have any comments on the proposed approach for determining the leverage in cases where a combination of approaches is used, for example, whether in practice the proposed approach is workable? Do you have any other better suggestions?*]

(d) subject to subsection (2), $P_{CIS\ exposure}$ is the principal amount or the credit equivalent amount, as the case may be, of the CIS exposure.

(2) If all or part of a CIS exposure held by an authorized institution constitutes the institution's direct holding, indirect holding, synthetic holding or future holding of a regulatory deductible item, the institution may calculate the $P_{\text{CIS exposure}}$ of the CIS exposure as the principal amount or the credit equivalent amount, as the case may be, of the CIS exposure minus the following amounts—

(a) any amount of the CIS exposure that is deducted from the institution's capital base under Division 4 of Part 3; and

(b) any amount of the CIS exposure that is risk-weighted in accordance with section X11(2) or (3).

[*Explanatory note: Section X12(2) is intended to address the issue of double counting the same exposure in capital requirement calculation.*]

II. Consequential changes to Part 1 (Preliminary), Part 4 (STC approach), Part 5 (BSC approach) and Schedules

The proposed amendments to Parts 4 and 5 are intended to provide that—

- *the risk-weights applicable to non-CIS exposures must be determined in accordance with Division 3 of Part 4; and*
- *the risk-weights applicable to CIS exposures must be determined in accordance with Division 4A of Part 4.*

Proposed insertions and deletions are highlighted in blue.

3. Section 2 (interpretation)

(1) Section 2(1), amend the definition of ***ECAI issue specific rating*** as follows[7]—

"***ECAI issue specific rating***, in relation to an exposure—

(a) subject to paragraphs (b), (c), ~~(e),~~ (f), (g) and (h), if the exposure is a non-securitization exposure to a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(i) is assigned to the exposure by an ECAI; and

(ii) is for the time being neither withdrawn nor suspended by that ECAI;

(b) in section 51, has the meaning given by section 51(2);

(c) in section 52, has the meaning given by section 52(4);

(d) subject to paragraphs (b), (c), ~~(e),~~ (f), (g) and (h), if the exposure is a non-securitization exposure to a person other than a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(i) is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this subsection; and

(ii) is for the time being neither withdrawn nor suspended by that ECAI;

(e) ~~in section 62, has the meaning given by section 62(4);~~

(f) in section 69, has the meaning given by section 69(11);

(g) in section 287, has the meaning given by section 287(11);

(h) in Schedule 7, has the meaning given by section 2(g) of that Schedule; and

(i) if the exposure is a securitization exposure, has the meaning given by section 227A;".

(2) Section 2(1), amend the definition of ***underlying exposures*** as follows—

"(a) in relation to a securitization transaction, has the meaning given by section 227(1); ~~or~~

(ab) in relation to a collective investment scheme, means—

[7] Based on the version as revised by the Banking (Capital) (Amendment) Rules 2018.

(i) an on-balance sheet exposure held by the scheme, including such an exposure arising from variation margin receivable in respect of transactions cleared by CCPs;

(ii) an exposure of the scheme to the underlying exposure of a derivative contract (within the meaning given by section 226A), or to the asset underlying an SFT, entered into by the scheme where, if the scheme were an authorized institution, it would be required to hold regulatory capital in respect of the exposure to such underlying exposure or asset under Part 4, 5, 6, 6A or 7, as the case requires;

(iii) a default risk exposure of the scheme arising from derivative contracts or SFTs entered into by the scheme; or

(iv) any other off-balance sheet exposure incurred by the scheme where, if the scheme were an authorized institution, it would be required to hold regulatory capital in respect of such exposure under Part 4, 5, 6, 6A or 7, as the case requires;

(b) subject to paragraphs (a) and (ab), in relation to a derivative contract (including a credit derivative contract) for the calculation of an authorized institution's market risk, has the meaning given to the definition of underlying exposure by section 281;".

4. Section 52 (calculation of risk-weighted amount of exposures)

(1) Amend section 52(2)(a) as follows—

"(a) subject to paragraph (b), an authorized institution ~~shall~~ must—

(i) calculate the risk-weighted amount of the institution's on-balance sheet exposures (except CIS exposures) by multiplying the principal amount of each such exposure, net of specific provisions, by the relevant risk-weight attributable to the exposure determined under ~~sections 55, 56, 57, 58, 59, 60, 61, 62, 63, 63A, 64, 65, 66, 67, 68 and 68A~~ Division 3; and

(ii) calculate the risk-weighted amount of the institution's on-balance sheet exposures that are CIS exposures in accordance with Division 4A;".

(2) Amend section 52(3)(ab) as follows—

"(ab) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must ~~calculate the risk-weighted amount of each of those exposures by—~~

(i) convert~~ing~~ the principal amount of ~~the exposure~~ each of those exposures, net of specific provisions, into its credit equivalent amount in the manner set out in section 71 or 73, as the case requires; ~~and~~

(ii) ~~multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under~~ determine the risk-weight applicable to the exposure in accordance with section 74; and

(iii) calculate the risk-weighted amount of the exposure—

(A) if the exposure in not a CIS exposure—as the product of the credit equivalent amount obtained under subparagraph (i) and the risk-weight obtained under subparagraph (ii); or

(B) if the exposure is a CIS exposure—in accordance with section X12;".

(3) Section 52(4), amend the definition of ***ECAI issue specific rating*** as follows—

"(a) in relation to an exposure to a person that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) ~~in relation to an exposure to a collective investment scheme, has the meaning given by section 62(4); or~~

(c) in relation to an exposure to a person that is a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI."

5. Part 4, Division 3 (determination of risk-weights applicable to on-balance sheet exposures)

Heading, after "**Exposures**"—

Add

"**other than CIS Exposures**".

6. Section 54A

Before section 55, add a new section as follows—

"**54A. Application of Division 3**

This Division does not apply to on-balance exposures that are CIS exposures.".

7. Section 62 (collective investment scheme exposures)

Repeal section 62.

8. Section 66 (other exposures which are not past due exposures)

Amend section 66(1)(b) as follows—

"(b) in any other case—

(i) equities held by an authorized institution that do not fall within section ~~62 or~~ 68A and are not CIS exposures to which Division 4A applies; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 55, 56, 57, 58, 59, 60, 61, ~~62,~~ 63, 63A, 64, 65 and 67 and are not CIS exposures to which Division 4A applies (including accrued interest if subsection (5) is applicable).".

9. Section 67 (past due exposures)

Amend section 67(1) as follows—

"(1) Notwithstanding sections 55, 56, 57, 58, 59, 60, 61, ~~62,~~ 63, 64, 65 and 66(2)(a), an authorized institution shall allocate a risk-weight of 150% to the relevant amount of a past due exposure.".

10. Section 68 (credit-linked notes)

Amend section 68(d)(i) as follows—

"(d) if the note does not have an ECAI issue specific rating, the institution must, subject to paragraph (e), allocate a risk-weight to the exposure that is the greater of—

(i) the risk-weight attributable to the reference obligation of the note as determined in accordance with sections 55, 56, 57, 58, 59, 60, 61, ~~62,~~ 63, 64, 65, 66 and 67 and Division 4A as if the institution had a direct exposure to the reference obligation; and".

11. Section 69 (application of ECAI ratings)

(1) Amend section 69(1) as follows—

"(1) An authorized institution ~~shall~~ must, in complying with ~~the requirements~~ a requirement under ~~any subsection of~~ section 55, 57, 59, 60~~, 61~~ or ~~62~~ 61 in relation to an exposure (~~referred to in subsection (2) as~~ ***concerned exposure A***) of the institution consisting of a debt obligation issued or undertaken by a person ~~or, for the purposes of section 62, consisting of an interest in a collective investment scheme,~~ where the debt obligation~~, or collective investment scheme, as the case may be,~~ has one or more than one ECAI issue specific rating assigned to it, determine the rating to be used in accordance with subsection (2).".

(2) Section 69(11), amend the definition of ***ECAI issue specific rating*** as follows—

"(a) in relation to an exposure to a sovereign, a bank, a securities firm or a corporate incorporated outside India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of external credit assessment institution in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) ~~in relation to an exposure to a collective investment scheme, has the meaning given by section 62(4); or~~

(c) in relation to an exposure to a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;".

12. Section 70 (authorized institutions required to nominate ECAIs to be used)

(1) Amend section 70(7) as follows—

"(1) For the avoidance of doubt, it is hereby declared that an authorized institution shall, for the purposes of this Part, treat as not having an ECAI rating any person~~, debt obligation, or collective investment scheme,~~ or debt obligation which, although falling within an ECAI ratings based portfolio of the institution, does not have an ECAI rating assigned to it by an ECAI nominated under subsection (1) by that institution in respect of that portfolio.".

(2) Section 70(8), amend the definition of ***ECAI ratings based portfolio*** as follows—

"***ECAI ratings based portfolio***, in relation to an authorized institution, means—

(a) the institution's sovereign exposures;

(b) the institution's public sector entity exposures;

(c) the institution's bank exposures;

(d) the institution's securities firm exposures; or

(e) the institution's corporate exposures~~; or~~.

(f) ~~the institution's collective investment scheme exposures.~~".

13. Section 74 (determination of risk-weights applicable to off-balance sheet exposures)

Amend section 74(1) as follows—

"(1) Subject to subsections (2) and (6A), an authorized institution ~~shall~~ must determine the risk-weight attributable to an off-balance sheet exposure ~~in accordance with sections 55, 56, 57, 58, 59, 60, 61, 63A, 64, 65, 66, 67 and 68A~~ as if it were an on-balance sheet exposure in accordance with—

(i) if the off-balance sheet exposure is not a CIS exposure—Division 3; or

(ii) if the off-balance sheet exposure is a CIS exposure—Division 4A.".

14. Section 82 (determination of risk-weight to be allocated to recognized collateral under simple approach)

Amend Section 82(1)(a)(i) as follows—

"(a) subject to paragraph (b)—

(i) must, subject to subparagraph (ii), determine the risk-weight to be allocated to the collateral in accordance with sections 55, 56, 57, 58, 59, 60, 61, ~~62,~~ 63, 66 and 68 and Division 4A as if the collateral were an on-balance sheet exposure; and".

15. Section 94 (on-balance sheet netting)

Amend section 94(1) as follows—

"(1) Where amounts owed by an obligor to an authorized institution in respect of on-balance sheet exposures (other than CIS exposures) of the institution are subject to recognized netting, the institution—

(a) may take into account the effect of the recognized netting in calculating its exposure to the obligor; and

(b) if a net credit exposure for the institution is the result of so taking into account the effect of the recognized netting, shall use the net credit exposure in calculating the risk-weighted amount of the exposure.".

16. Section 106 (calculation of risk-weighted amount of exposures)

(1) Amend section 106(2)(a) as follows—

"(a) subject to paragraph (b), an authorized institution ~~shall~~ must—

(i) calculate the risk-weighted amount of the institution's on-balance sheet exposures (except CIS exposures) by multiplying the principal amount of each such exposure, net of specific provisions, by the relevant risk-weight attributable to the exposure determined under Division 3; and

(ii) calculate the risk-weighted amount of the institution's on-balance sheet exposures that are CIS exposures in accordance with Division 4A;".

(2) Amend section 106(3)(ab) as follows—

"(ab) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must ~~calculate the risk-weighted amount of each of those exposures by—~~

(i) convert~~ing~~ the principal amount of ~~the exposure~~ each of those exposures, net of specific provisions, into its credit equivalent amount in the manner set out in section 118 or 120, as the case requires; ~~and~~

(ii) ~~multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under~~ determine the risk-weight applicable to the exposure in accordance with section 121; and

(iii) calculate the risk-weighted amount of the exposure—

(A) if the exposure in not a CIS exposure—as the product of the credit equivalent amount obtained under subparagraph (i) and the risk-weight obtained under subparagraph (ii); or

(B) if the exposure is a CIS exposure—in accordance with section X12;".

17. Section 108 (classification of exposures)

After paragraph (f)—

Add

"(fa) CIS exposures;".

18. Part 5, Division 3 (determination of risk-weights applicable to on-balance sheet exposures)

Heading, after "**Exposures**"—

Add

"**other than CIS Exposures**".

19. Section 108A

Before section 109, add a new section as follows—

"**108A. Application of Division 3**

This Division does not apply to on-balance exposures that are CIS exposures.".

20. Section 116 (other exposures)

Amend section 116(1)(b) as follows—

"(b) in any other case—

(i) equities held by an authorized institution that do not fall within section 117A and are not CIS exposures to which Division 4A applies; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 109, 110, 111, 112, 113, 114, 114A and 115 and are not CIS exposures to which Division 4A applies (including accrued interest if subsection (5) is applicable).".

21. Section 117 (credit-linked notes)

Amend section 117(a)(i) as follows—

"(a) the risk-weight attributable to—

(i) subject to subparagraph (ii), the reference obligation of the note as determined in accordance with sections 109, 110, 111, 112, 113, 114, 115 and 116 and Division 4A as if the institution had a direct exposure to the reference obligation;".

22. Section 121 (determination of risk-weights applicable to off-balance sheet exposures)

Amend section 121(1) as follows—

"(1) Subject to subsections (2) and (6A), an authorized institution ~~shall~~ must determine the risk-weight attributable to an off-balance sheet exposure ~~in accordance with sections 109, 110, 111, 112, 113, 114A, 115, 116 and 117A~~ as if it were an on-balance sheet exposure in accordance with—

(a) if the off-balance sheet exposure is not a CIS exposure—Division 3; or

(b) if the off-balance sheet exposure is a CIS exposure—Division 4A.".

23. Section 130 (on-balance sheet netting)

Amend section 130(1) as follows—

"(1) Where amounts owed by an obligor to an authorized institution in respect of on-balance sheet exposures (other than CIS exposures) of the institution are subject to recognized netting, the institution—

(a) may take into account the effect of the recognized netting in calculating its exposure to the obligor; and

(b) if a net credit exposure for the institution is the result of so taking into account the effect of the recognized netting, shall use the net credit exposure in calculating the risk-weighted amount of the exposure.".

24. Schedule 6 (credit quality grades)

Repeal Table D.